1812

THE NATIONAL CITY BANK OF NEW YORK

1949

Monthly Letter on
Economic Conditions
Government Finance

New York, February, 1949

General Business Conditions

THE business news continues to give evidence of the hesitation and slackening which was first commented on after the election. Hopes of a substantial increase in new orders after the holidays have not been widely realized, although some of the seasonal merchandise markets, where January shows are the rule, have turned in good reports. The soft spots continue to look soft, and have become a little more numerous. Forward operations are cautious almost everywhere.

On the other hand, few indications that the decline is becoming progressively severe are to be seen. Retail trade figures since Christmas have shown good increases over a year ago, which of course means that they have broken all records for the period. It would be premature to characterize as "general" a recession which is not cutting production of steel or, with very minor exceptions, of automobiles, utility and railway equipment, or of most nonferrous metals. Steel mill operations have been setting new high records each week. The automobile industry is headed for new peaks in passenger car output. Many other lines have in sight enough business to sustain high operating rates for a considerable time ahead.

Moreover, where curtailment has occurred special or temporary conditions have often played a part. In coal and even petroleum the slackening reflects in part the unseasonably warm winter in major consuming areas. In certain consumers' durables, such as refrigerators, the return of familiar seasonal patterns, overcome in recent years by shortages, is an element.

Food prices have continued downward, but prices of non-agricultural goods, despite some weaknesses, on the average have been steady.

Demand Less Urgent

But while business men recognize the spotty and often seasonal nature of the slackening, even those whose plants are still pressed to fill orders see a change in conditions. The primary change is that demand is less urgent, both from people and business. People have filled many pressing needs since the end of the war, and they can now hold off for lower prices or better quality. At the same time, pipelines are mostly filled, and both merchants and industrial purchasing agents are buying very conservatively. Even in steel, still the tightest of commodities, the effects of caution and catching up are felt in the shrinking of the gray market, which "Iron Age" describes as "only a shell of its former self". Demand for some nonferrous metals has softened. Many business men are reluctant to go ahead with new plans for expansion, both because building costs are high and because the outlook for profits is clouded by stiffening competition and possible tax increases.

In short, the return to buyers' markets, to seasonal fluctuations, and to competitive conditions which in many cases imply shrinking profit mar-

CONTENTS

gins, is spreading widely. For high-cost producers and distributors, including many of the eight hundred thousand (net) new businesses established since 1945, the going is becoming harder. One after another, all businesses will have to conform to changing conditions.

The supporting elements, however, are impressive. The recovery in department store sales, which in the four weeks ended January 22 were 4 per cent higher than a year earlier, is significant as demonstrating that the November-December slackening was not due primarily to lack of purchasing power, but to price resistance, unseasonable weather and other factors. Disposable income in November was equivalent to a seasonally adjusted annual rate of $196 billion, a new high record.

This figure is not likely to have declined much since. Many factors are operating to hold up personal incomes. They include not only the record employment at record wages still being enjoyed, but also farm price supports, unemployment compensation and other welfare benefits, and government payments generally. Buying power is supported by the immense volume of liquid assets which people hold in U. S. Savings Bonds and other forms. People have means, and when they can get what they want at satisfactory prices, they are buying.

The other side of the cautious buying by merchants is the reduction in their forward commitments, which have been cut back heavily. According to Federal Reserve figures, stocks plus commitments of department stores at the end of November were 7 per cent below a year earlier, and the figures for December undoubtedly will show a greater decrease. A comparison of this position with sales figures indicates that merchants will be coming to the markets steadily. What has happened is a shift of business from a forward to a current basis, made possible by increased supplies of merchandise and shortening of delivery dates. Although manufacturers would rather have longer orders on their books, in the interest of smooth operations, the shift has the merit of reducing market risk all around. If not overdone it is an element not of depression, but of stability.

Time to Cut Costs

The lesson to be drawn from these developments seems plain. The question is whether production will go on and payrolls be maintained, and the answer is that they will if the price and quality of output are such that people can sell to each other. Since the inflation has priced many people with lagging incomes out of the market, the essential matter is to keep costs and prices down.

The general situation makes it plain that demands for fourth round wage increases are untimely. An example was set for all the industries in a decision handed down January 17 by the permanent arbitrator, Professor Douglass V. Brown of Massachusetts Institute of Technology, in the case of a 10c an hour increase requested by the Textile Workers Union of America from the Fall River and New Bedford textile mills. Weighing the arguments, Professor Brown said:

> A mistaken granting of a wage increase at this time, followed by no increase or an insufficient increase in demand, would open the door to the possibility of serious unemployment and loss of income to both employes and companies . . . Taking into account the present situation in the industry, and weighing as best I can the probabilities in the immediate future, I am of the opinion that the denial of the wage increase at this time is in the interest of the companies, the union and the employes.

What is at stake in this case, as in many others, is the balance of price and wage relationships in the whole economy. Prices of the goods produced by these mills have dropped below the peak by nearly half in some constructions, and by 30 to 35 per cent on the average, the decision says. Many prices are down to OPA levels, but Prof. Brown noted that wages are 26c an hour higher than at that time. Despite the price declines, largely at the expense of profits, the mills have been unable to sell their output. They have accumulated inventory, and have cut their operations some 25 per cent. A wage increase now would raise costs, and would raise prices or shrink profits further. In either case additional curtailment could be expected. When the markets will no longer absorb their products, workers who seemingly gain through higher wage rates must expect to give up the gains through unemployment. The markets narrow because other people do not, and in most cases cannot, receive equivalent increases in income. Some, as farmers, are receiving smaller incomes.

Another example for the country has been set by the Amalgamated Clothing Workers, fourth largest C.I.O. union, which has decided not to press for a fourth round wage increase. Still another is the case of union carpenters in Springfield, Mo., who, according to a dispatch to the New York Times January 15, admit they have priced themselves out of jobs and propose to take a 20 per cent wage cut to help stimulate construction. But the dispatch added that other unions, which appear to have less non-union competition, were cool to the idea.

The paramount interest of everyone should be in maintaining production, which is the only source of real welfare and progress, and sustaining employment. Production depends upon the maintenance of terms of trade which will enable people to exchange their products. For a long time the relations of wages, costs, prices and incomes have seemed to have little importance in the situation. Inflated demands overcame and obscured all distortions and all lags of income, including those which the inflation created. But as inflationary monetary pressures are absorbed and commodity and merchandise pipelines are filled, the subsidence of demand makes the terms of trade again of first importance, as the Springfield carpenters have discovered. The phrase "priced out of the market" takes on a more urgent meaning.

The Government and Business

It would seem from the foregoing that President Truman's concern over inflation, which led him to repeat in his messages to Congress his former requests for measures to control it, is mainly retrospective, insofar as it applies to the private part of the economy. If there is further danger of inflation, it must lie in the contemplated increase in government spending.

In the Economic Report, under the headings "Policies to protect the victims of inflation" and "Policies to promote balanced economic growth," the President presents a program which would further add to the already huge spending-lending-guaranteeing activities of the Government, not only in fiscal 1950 but progressively thereafter. The President recommends, in addition to international aid programs, the following:

Increased benefits under the old age and survivors insurance.

Increase in the minimum wage from 40c to at least 75c an hour.

Increase in public assistance for relief.

Expansion of public power programs.

A variety of farm measures, not very definitely spelled out.

Passage of the comprehensive housing bill with an increase in the quota from 500,000 units of low rent housing over five years to a million units within seven years.

Federal aid for slum clearance and redevelopment.

Federal aid for education.

A national health insurance program, including federal grants for hospital construction.

Widening of the old age and unemployment insurance systems, and inclusion of disability insurance.

The potential inflationary character of these proposals is squarely faced. The President says:

> We must fulfill the requirements of our essential programs — national defense, international reconstruction, and domestic improvements and welfare — even if doing so may require the temporary exercise of selective controls in our economy . . . While we must deal promptly with the problem of inflation, we must not unduly hold back undertakings that are needed to preserve and develop our employment opportunities and our productivity in later years.

On the other hand, the President also says,

> The Government is equally committed to an anti-depression policy . . . In times like the present when the economic situation has mixed elements the Government needs both anti-inflationary weapons and anti-deflationary weapons so that it will be ready for either contingency. It may even be necessary to employ both types of measures concurrently in some combination.

In summary, therefore, the view of the President and his advisers is that the spending program can be used to support the economy against recession, if that is called for. But it is to be carried out nonetheless, even if the result is to raise the sum total of market demand above productive capacity. In that case its inflationary effects are to be restrained by taxation, credit restriction, price and other controls, commodity allocations, and the allied measures for which he asks Congressional approval.

A Momentous Debate

The presentation of these proposals opens a momentous debate. To describe the program merely as ambitious and far-reaching is an understatement, for such words convey no inkling of the immensity of the questions raised and their profound bearing upon the country's economic and social life and its future welfare.

Looking first at the purpose to stabilize the economy and maintain full employment and full utilization of resources, and at the same time avoid the perils of inflation, can the proposed government action be effective? When the danger is inflation, will the direct controls really repress it while the Government constantly pours fuel on the fire? The evidence of history is to the contrary. The experience of this country is (1) that price and wage controls are impracticable in times of peace; (2) that if they did work they would diminish production and distribution; (3) that for various reasons, some good, some bad, counter-inflationary policies which would most effectively offset government spending — such as higher interest rates to check private spending and credit expansion — are not forcefully employed. In the postwar inflation, the theory of the compensated economy has not worked. Government policy has prolonged and extended the boom.

When the danger is deflation, can the supporting measures function as effectively as intended?

On the affirmative side, the chief point is that the Government is immensely more influential in the country's economy than ever before. Federal and local tax authorities now take — and redistribute — from people and corporations a sum equivalent (in 1948) to 23 per cent of the value of all goods and services produced in the country. The governments themselves were purchasers of 14 per cent of these goods and services in 1948, and will be a still larger factor in 1949. These government expenditures will not fluctuate with business swings. They represent in effect an unshrinking segment of business, and in case of recession they will exert a stabilizing influence proportionate to their weight.

This stabilizing influence will be greater or less depending upon the financing of the Government's requirements. If the Treasury collects a surplus by taxing away funds from the income stream, and uses it to retire debt owed to the banking system, it extinguishes credit and reduces money purchasing power. If it operates at a deficit and borrows from the banking system, it creates credit and adds to money purchasing power. Thus the Treasury can influence the expenditures of others in a deflationary or inflationary direction. It also influences the psychology of people and business.

The Present Fiscal Position

At present the goverment fiscal position is moving from one of a huge cash surplus, over into a balanced position or perhaps a cash deficit. Thus a deflationary pressure that was exerted during 1948 is being reduced in 1949 and perhaps lifted entirely. The change is recognized in all calculations of the outlook as a strong supporting factor. Many believe it is a sufficient change to offset any likely contraction in construction and other private investment. Some think it signifies another inflationary upsurge to come.

On the other side of the argument, there is a question whether government spending carries enough weight, actually and psychologically, to overcome other deflationary influences. It would be impossible for the government, taking say 15 per cent of the country's full production, to add enough to its purchases to support the entire economy if the people and business who take 85 per cent should contract their spending sharply and start to liquidate inventories and bank debt broadly. An inflationary government program may prevent private deflation from getting started. But even this is far from certain because government spending and allied policies have depressing influences also.

Taxes Repress Growth

The foregoing suggests the next question, which concerns the effect upon the private part of the economy of the spending proposals. If they are financed by increases in taxation, in the manner asked, they will have repressive effects. As was said in this Letter last month, the issue is not merely that of taking away from one segment of the population to give to another. The more important question is what the taxation, aimed more at profits and saving than at private spending, may do to destroy incentive, restrict growth and check long-run progress.

Within the past month the McGraw-Hill Publishing Co. has made public the results of a survey of business needs for new plant and equipment and of planned expenditures for the purpose. The survey shows that in 1949 American industry plans to spend only about 5 per cent less than was spent in 1948. It shows, moreover, that industry plans to spend in the years 1950-53 almost three times the 1949 amount, to a total of $41 billion for the groups covered in the survey. It is expected that three-fourths of this amount will be spent for replacement and modernization, which will reduce costs and cheapen the real price of goods.

The survey goes on to say, however, that business will not and cannot carry out these plans unless it has confidence and can get the money. It says that the President, in his budget message —

> proposed new taxes which would divert a substantial share of the money industry is using for expansion and improvement. Moreover, he said nothing about the vital issues now freezing the capital markets.
>
> It is not possible to have it both ways. Fulfillment of the President's tax program means cutting industry's program for new and better equipment. It means slowing down industrial progress. It means delaying the advance toward much higher standards of living tomorrow in order to have a little more government spending today.

If the funds are provided through Treasury deficits the benefits to some will be at the cost of inflation, whch affects all. It is almost impossible to foretell what effect a resumption of deficit financing may have on the economic situation in the short run, for in many minds it causes alarm and lessens confidence. In the long run, however, it is inflationary.

Thus an immense expansion of government spending confronts the Government with Hobson's choice. It can repress enterprise by taxation, or embrace inflation with all its evils and cruel illusions. Nor, as already stated, do price and allied controls offer a practicable way out.

They are incompatible with free enterprise, burdensome, disruptive, and in practice unworkable.

The Source of Welfare

Apart from defense and foreign aid expenditures, most of the proposed increase in spending falls in the general category of social benefits, or the promotion of welfare. The Economic Report speaks of "economic justice", of "security and welfare", of "domestic improvements", of development of "human resources" — all objectives against which no one could possibly raise a voice, and toward which everyone wants to make as much progress as possible. A proportion of the country's product always has been and always will be diverted from those who produce it, and employed for welfare purposes of the general character listed; and it is inevitable and desirable that this proportion should increase as the productivity of the economic organization increases. But in the debate none should lose sight of the fact that through all history, and undoubtedly in the future as well, the greatest advances in human welfare come through the growth of the industrial organization, the improvement in its output, and the almost automatic distribution of its benefits through the competitive economy. They come by increasing the productivity of the individual, through invention, research, saving, investment, and work.

The welfare goals which are now set can be reached only along this road. What is more, they will inevitably be reached if the emphasis is on these things. The great and dangerous illusion is to expect that they can be reached if, while heavier burdens are placed on the productive system, the effectiveness of its operation is diminished. The practical test by which to judge the proposals is whether, on top of defense and foreign aid, the country can afford them. It is no answer to say on behalf of any part of the program, as the proponents of that part naturally do, that the cost is small. The vital consideration is the total cost, and not merely the cost in money, but in the effects on the productive organization.

The Budget for the U. S.

In submitting to the Congress his budget for the fiscal year beginning July 1 next, President Truman described this document as "the clearest expression that can be given at this time to the program which the Government of the United States should follow in the world today." In it we see reflected the dollar costs of implementing the programs and philosophies which were outlined in the President's State of the Union message and have characterized national policies since the war.

As shown by the accompanying long-term table, the estimated expenditures of close to $42 billion for the coming fiscal year are exceeded only by the astronomical totals of World War II and are actually 42 per cent of the peak year of global war. They are about $1.7 billion above the President's latest estimate for the current fiscal year ending in June, and some $8 billion above the postwar low in 1948. These overall totals, as given by the President, do not allow for the provision in the Foreign Economic Cooperation Act, passed by the 80th Congress, directing that $3 billion of ECA costs in 1949 be charged against the 1948 budget.

United States Government Budget Receipts, Expenditures, and Public Debt, 1914-1950

(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Total Net Expenditures	Net Surplus or Deficit	Public Debt June 30
1914	$ 735	$ 735	$ 0	$ 1,188
1917	1,124	1,977	— 853	2,976
1918	3,664	12,697	— 9,033	12,244
1919	5,152	18,515	—13,363	25,482
1920	6,695	6,403	+ 292	24,299
1925	3,780	3,063	+ 717	20,516
1930	4,178	3,440	+ 738	16,185
1932	2,006	4,535	— 2,529	19,487
1934	3,116	6,011	— 2,895	27,053
1936	4,116	8,666	— 4,550	33,779
1939*	5,097	8,959	— 3,862	40,440
1940	5,296	9,206	— 3,910	42,968
1941	7,227	13,387	— 6,159	48,961
1942	12,696	34,187	—21,490	72,422
1943	22,201	79,622	—57,420	136,696
1944	43,892	95,315	—51,423	201,003
1945	44,762	98,703	—53,941	258,682
1946	40,027	60,703	—20,676	269,422
1947	40,043	39,289	+ 754	258,286
1948	42,211	33,791†	+ 8,419†	252,292
1949 Est.	39,580	40,180†	— 600†	251,569
1950 Est.	40,985	41,858	— 873	251,925

*Figures since 1939 revised to new budget basis to exclude tax refunds from receipts and expenditures. †Official budget summary does not allow for $3,000,000,000 directed by Congress to be transferred from the 1949 budget to the Foreign Economic Cooperation Trust Fund and charged against 1948, even though actually spent in 1949.

The President offers no encouragement that the $42 billion expenditures projected for fiscal 1950 will mark the top. This figure, he pointed out, makes no allowance for cost of assisting in the re-arming of Western European countries, now under discussion, for which he intends to present supplementary requests. Continuing, he warned that

> Fiscal prudence requires that we consider the Government's program, not on the basis of a single year alone, but in the light of the continuing national policies already adopted. It must be recognized that expenditures in the fiscal year 1951 are likely to be larger than those for 1950.

Request for More Taxes

On the revenue side, the President forecasts budgetary receipts at approximately $41 billion, an increase of nearly $1½ billion over those now estimated for the current fiscal year, and

within $1¼ billion of the total for fiscal '48. This is notwithstanding the cut in individual taxes made effective by the Revenue Act of 1948 which the Administration had predicted would reduce revenues by $5 billion.

Balancing estimated receipts against expenditures reveals, as the table shows, small deficits (less than a billion dollars each) for the fiscal years '49 and '50. To cover these deficits and yield a surplus "to provide a margin for contingencies, to permit reduction of the public debt, to provide an adequate base for the future financing of our present commitments, and to reduce inflationary pressures," the President asks for $4 billion annually of new taxes within the regular budget — to come from corporations, medium and upper bracket personal incomes, and from increased gift and estate taxes.

In addition, the President wants nearly $2 billion more annually in increased payroll taxes on employers and employes to start health insurance and expand social security, financed through trust funds outside the regular budget.

All this is to be put on top of the extremely high tax structure the country is already carrying.

Expenditures by Major Functions

This enormous total of expenditures, and the heavy burden of taxes that accompanies it, demand that the public give serious consideration to where the money is going. The following table shows the estimated expenditures for fiscal '49 and '50 by the major classifications listed in the budget, together with actual expenditures for fiscal '48 and for prewar 1939.

Budget Expenditures by Major Programs

(In Millions of Dollars)

	1939	1948	1949	1950
National defense	$1,074	$10,924	$11,745	$14,268
Veterans' services, benefits	559	6,567	6,799	5,496
Interest on public debt	941	5,188	5,325	5,450
International affairs	19	4,782	7,219	6,709
Social welfare, etc.	3,996	1,858	1,963	2,358
Transportation, communication	512	1,267	1,757	1,586
General government	556	1,504	1,187	1,224
Agriculture	1,198	575	1,805	1,662
Natural resources	214	1,091	1,616	1,861
Housing facilities	154*	82	349	388
Finance, commerce, industry	52	88	102	107
Labor	11	188	184	187
Education and research	44	75	85	414
Reserve for contingencies	—	—	45	150
Adjustment	63*	—388	—	—
Total expenditures	$8,959	$33,791	$40,180	$41,858

*Excess of credits, deduct.

The table reflects the continuing dominance in the budget of our international and national defense programs, which together are estimated at $21 billion for 1950, or half of all budget expenditures. Veterans' services and benefits and interest on the public debt add another $11 billion, or 26 per cent of the budget total.

This leaves for all activities of the Government other than the four major categories — national defense, international affairs, veterans, and interest — $10 billion or 24 per cent. While this may seem a modest figure when measured against the grand total, it is more than the entire expenditures of the Government in 1939, one of the biggest spending years of the New Deal before the war.

The Rising Trend of Costs

All but four of the fourteen categories show estimated increases for 1950. Largest of all is the boost of $2½ billion to $14.3 billion in expenditures for national defense, or well within the $15 billion ceiling ordered by the President. Included in the total is $600 million for initiating a universal military training program, which Congress has opposed, and $525 million for stockpiling of strategic and critical materials. Though contemplating increased expenditures for aircraft procurement, the budget cuts back the Air Force's requested 70 groups — approved last year by Congress over the President's veto — to 48 combat groups and 10 squadrons, together with 27 groups of the Air National Guard.

Whether it will be possible to hold defense expenditures within the budgeted total remains to be seen. Pressure from the military services for increases is terrific, and in truth no one wants to be niggardly when the security of the country is involved. At the same time it must be recognized that there are limits to the strain that can be imposed safely on the economy in supporting a defense establishment; also that the effectiveness of military spending is not necessarily measured by the dollar amount. Much depends on how and for what programs money is spent, the degree of efficiency at all levels, and whether as a result of interservice rivalries or faulty planning the available resources are spread too broadly instead of being concentrated where most needed. These principles were clearly stated by Secretary of Defense Forrestal in his recent annual report as follows:

> We must see that expenditures for national security yield full value; that they are made for essential projects only, and that they are kept within the country's capacity to pay for them. This nation must hold a position of military readiness, created within reasonable limits. One of the great problems from which the Military Establishment cannot divorce itself is the complex one of securing proper balance between military necessities and national solvency. The capacity for making war is not separable from economics any more than it is from diplomacy.

In none of the four major expenditure categories listing decreases for 1950 does the lowered projection appear very solidly based. Decline in

the veterans' services and benefits reflects the tapering off of readjustment benefits, but the President warns that the long-run trend of compensation and pension costs and of hospitalization and medical care is gradually upward, indicating that "over-all expenditures under present legislation will remain high even after the completion of the temporary programs under the Servicemen's Readjustment Act."

Meanwhile pressure from veterans' organizations for additional bonus and pension payments continues, no doubt prompting the President's declaration that, with veterans and their families soon to constitute 40 per cent of the population, "the necessity for new or extended benefits to veterans without service disabilities should be judged, not solely from the standpoint of service in our armed forces, but in the light of existing social welfare programs available to all, veterans and nonveterans alike."

Regarding international affairs, the President points out that the small decline projected does not allow for any new programs of providing military supplies to certain foreign countries. Apart from this he is more hopeful for the foreign program, expecting expenditures for economic aid to decline in subsequent years with continued progress towards world recovery. This is in accord with the principle laid down in the European Recovery Program that such expenditures should diminish from year to year.

An estimated decline in expenditures for agriculture is based largely on the assumption that outlays by the Commodity Credit Corporation for crop support will be lower next year. Yet, as the President says, "If 1949 production should equal the magnitude of the 1948 crops, expenditures of the C.C.C. would be considerably larger in the fiscal year 1950 than now estimated."

Are Budget Cuts Possible?

Here indeed is a dismaying prospect for the taxpayer and for all who realize the dangers in this new upturn in government spending. Present levels are already high by any standards other than the fantastic budgets of World War II, with their aftermath of inflation of prices and living costs, and the resultant inequities and destruction of savings.

Yet the President, in presenting the 1950 budget, said:

> The plans of each government agency have been thoroughly reviewed, and the amounts shown in the budget represent, in my judgment, the minimum requirements for the next fiscal year. I believe that this budget reflects the necessities of our national policy and the desires of our people.

Many will challenge this statement that our $42 billion budget affords no room for economies.

There are two broad approaches to this problem: one, through reorganization and increased efficiency of government departments so as to obtain greater value for the money spent; the other, through elimination or postponement of government activities not considered essential or urgent. Both need to be carefully explored.

Evidence of the Hoover Commission

On the savings to be derived from increased efficiency and better management, the most impressive evidence is that being brought out in reports of sub-committees of the Hoover Commission on Organization of the Executive Branch of the Government. This commission, headed by the former President and non-partisan in character, was established by Congress in 1947 to make a thorough-going examination of the government structure and to submit recommendations for its improvement. It parcelled out the job to twenty-four sub-committees, or "task forces", of specialists dealing with a separate government department or sphere of activity. After months of study, these sub-committees have been reporting to the commission, and their reports, as they have been made public, have been illuminating.

For example, the sub-committee on the National Security Organization, headed by Ferdinand Eberstadt, former chairman of the Army-Navy Munitions Board, who helped draft the military unification law, found serious defects in the defense set-up. While the organization "is, on the whole, soundly constructed," it "is not yet working well." Costs of the $15 billion military establishment "appear to be unduly high, in terms both of the ability of the economy to sustain them and of the actual return in military strength and effective national security."

The report referred to the continuance of "intense interservice rivalries," and was particularly concerned by the "inadequate liason that still exists" between foreign policy and national military power. "Our foreign and military policies are not yet firmly tied together."

The military services "are far too prodigal with government funds." They lack "a sense of cost consciousness or a general realization of the vital importance to our national security of utmost conservation of our resources." The military budget needs "a major overhaul," with adequate means for checking, auditing, and control. Stressing the "urgent need" of better fiscal policies and close inventory control, the report cited as ex-

amples that the Army was able to account for only 16,000 of 25,000 tanks it had on hand at the end of the war, and that "committee staff members discovered in the original budget estimates requests for the modernization of 103 more tanks (of a certain type) than the Army possessed." In another item a misplaced figure added some $30,000,000 to the budget estimates.

"These and many other evidences of outmoded organization and obsolete fiscal procedures," the report said, "convinced the committee that substantial savings, without diminution of combat efficiency, are possible."

Other Examples of Waste

Further examples of poor coordination and control resulting in waste of public money appeared in the Hoover Commission "task force" reports on the government medical services. We quote from a summary by Howard A. Rusk, M.D., in the New York Times of January 9, as follows:

> In the New York City area the Federal Government is planning to spend over $100,000,000 for hospital construction, although there are four Army and Air Force hospitals which, with unified management, could be closed, thus reducing the requirements for medical officers by 80 per cent, while still raising the standards of medical care.
>
> In Houston, Texas, the Veterans Administration is building a $25,000,000 neuropsychiatric hospital virtually next door to a Navy neuropsychiatric hospital, which is only 10 per cent occupied . . .
>
> In the current VA $1,100,000,000 hospital construction program, costs per bed are ranging from $20,000 to $30,000 (and in one instance $51,000), as compared with the $16,000 per bed costs of building voluntary hospitals.
>
> Nearly half of the new VA hospitals are being built or planned in areas where experience has shown it will be difficult or impossible to obtain adequate medical staffs . . .

It is pointed out that one factor in increased medical costs is that some 900,000 dependents of Army and Air Force personnel are given free medical care under a sixty-year-old appropriations act – designed primarily for frontier outposts – authorizing medical officers to care for dependents "whenever practicable." We have referred in these pages before to the fact that some two-thirds of the veterans under treatment in veterans' hospitals are there for ailments that have nothing to do with their military service. Though federal laws state that veterans with non-service-connected disabilities may be hospitalized only if a "bed is available," the "task force" report states that 100,000 VA beds are being built or planned "which serve no purpose except deliberately to make beds available to non-service-connected cases."

An so the story goes – far more than we have space to quote. Mr. Hoover estimated that, without changing the functions of the Government, as much as $3 billion could be saved annually by improving the administration of government departments and agencies.

Along the same tack was some forceful and picturesque testimony by Lindsay C. Warren, Comptroller-General of the United States, in appearing before Congress on behalf of President Truman's request for authority to reorganize the executive branch. Characterizing the existing system "a hodgepodge and crazy quilt of duplications, overlappings, inefficiencies and inconsistencies with their attendant extravagance," he declared further:

> It is probably an ideal system for the tax eaters and those who wish to keep themselves perpetually attached to the public teat, but it is bad for those who have to pay the bill. That is why I say the Government should put its house in order.

Reduce Government Functions

The second approach to the problem of economies is by reducing the number of things we ask the Government to do for us. At a time when we have to pay such an enormous premium for insurance against war, it is common prudence to limit outlays in other directions.

Reports of the President's Council of Economic Advisers have emphasized the need to curb inflationary pressures. For one thing they have advised against any undue expansion of public works either by state or local governments or by the Federal Government. Yet federal civil public works expenditures are scheduled to reach an all-time high this fiscal year, totalling $2,429 million, as against $1,620 million in 1948. Civil public works requests for 1950, however, contemplate a total expenditure of $2,959 million – 22 per cent above 1949 and 83 per cent over 1948. Federal grants-in-aid to state and local governments will amount to $1,963 million in fiscal '49, and if the President's requests are approved they will run to $2,480 million in 1950.

Expenditures budgeted under "social welfare, health, and security" total $2,358 million for fiscal '50, up nearly $400 million from '49. An apparent decrease in this item compared with prewar '39 is caused by a decline in expenditures for work relief and direct relief from more than $3 billion that year to practically nothing at present; non-relief expenditures have more than doubled. Actually, expenditures listed under this heading hardly begin to reflect the billions of dollars being spent or proposed in extension of the "welfare state" under "veterans", "agriculture", "housing", "education", and other headings. This is to say nothing of the huge outlays

financed through social security taxes and trust funds outside the regular budget. Moreover, as Senator Bridges recently put it, the budget figures represent in many cases only the "initial purchase" but not the "upkeep" of the social programs. This is notably true of the proposed highly controversial health insurance, for which the budget provides for a beginning cost in 1950 of $15 million direct expenditures and $260 million trust fund appropriations. The ultimate cost nobody really knows.

The Council of thirty-one State Chambers of Commerce estimated that the commitments involved in the domestic spending programs proposed by President Truman ultimately would add at least $14.8 billion a year to the nation's permanent tax burden. The Council went on to point out that "many of the new programs, by their very character, may be expected to effect lasting and radical changes in our economic structure".

Where's the Money Coming From?

It is one thing to talk about all these things in ordinary times, but different when we have this terrific burden resulting from world unsettlement and disorder. It may be true, as the President said in a quotation cited earlier, that this budget "reflects . . . the desires of our people". But there is a question whether the people really understand the implications of such enormous spending. It is significant that in a public opinion poll on the "Fair Deal" program conducted by Elmo Roper and reported in the press of January 13, public sentiment was found to favor by large margins such measures as government-sponsored low-cost housing, extension of social security, farm price supports, and extension of the Tennessee Valley Authority principle, but the people (the report said) "are three-to-one *opposed* to raising taxes or even to restoring them to their 1947 level." In other words, the public wants these things, but does not want to pay for them. Where, then, is the money coming from?

Apparently, many people feel that it can come from the corporations and the relatively well-to-do. But already the tax burden upon production and enterprise is such that the vigor of the country's economic growth is threatened. There can be no real advance in the welfare of our people if these vital forces are smothered and discouraged.

"Featherbedding" on the Railroads

A month ago, we used the new machines for continuous mining of coal to illustrate the principle whereby the introduction and widening use of labor-saving machinery has cut costs of production, made possible the remarkable rise over the years in the general standard of living, the shortening of working hours, and, often, reductions in industrial hazards. As was indicated then, obstacles often arise to the full realization of labor savings from technical improvements, as from interests that want to protect the *status quo* and insist on keeping on the payroll men who are no longer necessary in their formerly assigned jobs.

Some of the make-work rules and laws in railroading, known in the trade as "featherbedding," were brought to public attention in the 1948 election campaigns when voters of California were faced with the issue of the amendment of a State law which specified the number of brakemen (in excess of a basic two) freight trains operating in California must carry. The decision of the electorate, by a margin of 1,767,587 to 1,703,303 votes, was to amend the provision and leave it up to the Public Utilities Commission to prescribe the number of brakemen necessary on freight trains "to promote the safety of . . . employes, passengers, and the public." The law as now amended contains the significant proviso that "the Commission shall not require employment of such number of brakemen as will result in featherbed practices."

The repealer was brought before the electorate through the efforts of the four major railroads serving the State – the Union Pacific, Southern Pacific, Santa Fe, and Western Pacific – and a nonpartisan "California Committee against Featherbedding." The campaign had the support of business men quite generally, farmers and farm organizations, housewives, and many "rank-and-file" trade union members. In the course of the campaign, featherbedding in general came under attack, not only as practiced in railroading, but also in construction and other trades. It was stated that featherbedding practices, all told, add as much as 20 per cent to living costs. The saving in the change in the California law, which covered simply the matter of excess brakemen on freight trains, was put at $3 million a year.

The law at issue, often alluded to by railroad men as the "full caboose law," dated back to 1911. It was originally passed as a safety measure when it was feared that the railroads would underman their trains and have too many accidents if fixed requirements and penalties were not provided by law. The law required 1 fireman, 1 engineer, 1 conductor and 2 brakemen on all freight trains. However, in addition, the law required 3 brakemen for trains of 50 cars, 4 brake-

men for 76 cars, and additional brakemen depending on the grades of the tracks. Under the law a train which operated safely in Arizona with 3 brakemen and in New Mexico and further east with 2 brakemen, under comparable grades, had to be manned in California with 5, 6 or even 7 brakemen.

In 1911, additional brakemen unquestionably were required on steep mountain grades. But since then the modern airbrake has been universally adopted. At the same time the automatic switch, double-tracking, block signal systems, and improvements in rolling stock and equipment generally have cut down or eliminated situations for which extra brakemen might be required. Interstate Commerce Commission rules now actually forbid the use of handbrakes except in emergency or when trains are broken up in the yard. In an emergency the working brakeman never knows what he may be called upon to do. But his main job in normal operation of a freight train today is not to operate the brakes but to watch the cars ahead, if he is in the caboose, or behind, if he rides in the locomotive, to guard against a "hot-box" or other sources of accident or damage to the train.

The Question of Safety

Opposition to the amendment came from the railroad brotherhoods and was centered on the question of safety. Here, fortunately for both sides to the argument, there were some comparative statistics not only on accident experience in other States but also on experience in California with and without the "full crew" law. During the manpower shortage of the war period the law was suspended by general consent and the railroads were permitted to operate with "short crews" so that troops and munitions would flow without interruption to war fronts. The Trainmen's Brotherhood presented Public Utility Commission statistics showing a considerable increase in "accident rate" during thirty months that the law was suspended, and some falling off in 1946 when the law came back into force. It was brought out in the campaign that the figures used by the Brotherhood were heavily influenced by numerous accidents of a trivial sort, in shops, round-houses, and stations — accidents which had nothing to do with freight operations out on the line where the size of the train crew might have an influence.

The California Committee Against Featherbedding, using the same basic data, narrowed their study to freight train operations and found a decline of nearly 10 per cent in "accident frequency" during the period that the law was suspended and a drop of one-third in casualties among freight brakemen in trains operated with "short crews." The Committee also drew from Interstate Commerce Commission reports to show that accident and casualty rates have run much higher in California than in other States since 1946 when the full crew law went back into effect.

The Trainmen's Brotherhood made a further point that engines and cars are much larger now than they used to be, that both are still subject to many mechanical failures, and thus, impliedly, that more men are needed to guard against such failures. Some of the Committee's most telling arguments were those in rebuttal of this reasoning. Briefly, the Committee maintained that new and improved safety devices had reduced risks of mechanical failure and denied that enlargement of the train crew reduced the inevitable risk of manpower failure. In case of either mechanical or manpower failure, on the other hand, a bigger crew exposed more men to the hazards of injury. The Committee cited specific cases of accidents and damage to "full crew" trains which one alert brakeman could easily have prevented. The Committee also cited accidents directly resulting from special train stops made to pick up or drop extra brakemen carried in compliance with the law.

The Question of Unemployment

One other issue that naturally came up was whether amendment of the "full crew" law would not throw a good many people out of work. A three million dollar a year saving from repeal, as stated by the Committee, would mainly come from reduced payrolls for extra brakemen. At $500 a month, which the Committee gave as the average pay of a brakeman, about five hundred men would have to be dropped from the payrolls of railroads operating in California to bring about the $3 million saving.

The California Committee Against Featherbedding met this argument by pointing out that of the 2,700 brakemen employed in the State in freight operations, about 440 men a year retire on pension, are transferred to other areas, are assigned to different work, or leave their jobs for one reason or another. Thus the number of men who would lose their jobs would be fairly comparable to the regular turnover of men in one year's time.

In this whole matter of possible unemployment resulting from elimination of a featherbedding practice there is the basic question whether you can put a man "out of work" who, for the most

part, is "just being carried along for the ride." The best thing for the man himself, not to mention the railroads and shippers and consumers who have to provide his wages, is a job where he puts in a genuine day's work for his pay. And there are few things more degenerating to the morale and effectiveness of a man who wants to earn his pay than to be surrounded by people who collect wages for doing little or nothing. As proponents of the repeal of the California law stated, "featherbedding undermines the dignity of honest labor and discredits its just demands."

In a study entitled "Transportation and National Policy," put out by the National Resources Planning Board in 1942, railroad "full crew" legislation was discussed in the following terms:

> Fair consideration of the merits of such measures is difficult because their safety aspects are not easily separated from their results in preserving jobs. Solely as a means of safeguarding employment, they are not in the public interest, since the shipping public is entitled to the most efficient transportation service at the lowest cost consistent with safety, fair labor standards, and fair returns to investors. There are other and better ways of meeting problems of employment and unemployment.

A Continuing Problem

The action of the California electorate on their "full crew" law stands as testimony to the fact that these principles are understood and endorsed by large bodies of citizens who have taken the trouble to think them through. Similar laws requiring extra brakemen still stand on the statute books of New York, Indiana, and a dozen other States as a hidden tax on all users of railway transportation service through these States. And excess crew laws are only one of several types of "featherbedding" on the railroads which have come to the attention of Congress. Yet proposals have constantly been pressed in State legislatures to enact new laws to make more jobs on the railroads and, incidentally, to add to the costs of transportation. Enactment of federal statutes for similar purposes has only been prevented by the effective opposition of the railroads, acting directly in behalf of the efficiency of their own operations, and collaterally in behalf of their customers and the general public.

Right now pressure is being brought to bear on the railroads to accept changes in operating rules which would require a second fireman and a second engineer on diesel locomotives. Mr. D. P. Loomis, chairman of the western carriers' wage committee, has stated that the issue, on which a strike is now threatened, involves "nothing but flagrant featherbedding." Quoting further from Mr. Loomis:

> Diesel locomotives are adequately manned with an engineer at the controls and a fireman who has little else to do but watch the track. The extra crew members demanded by the unions would just go along for the ride and the pay. Their pay would be in the top brackets and would add millions of dollars to railway operating costs.

At this very same time the Interstate Commerce Commission is urging the railroads to cut their costs. The Annual Report of the Commission for 1948, after reviewing the increases in freight rates required by increases in wages, costs of fuel, etc., points out that "rate increases may be carried to the point where they are largely self-defeating."

> Decentralization or relocation of industries and to an extent of population, the use of substitutes, recourse to foreign markets, and diminution of tonnage or travel and of revenue therefrom, are consequences when the price of transportation is forced upwards by costs to a level which the traffic will not bear.

"Much more," the Commission said, "must be done to increase the efficiency and reduce the cost of railroad operations." While the responsibility for effecting improvements is placed upon the railroads, it is recognized that "the cooperation of employees, from top to bottom, is a first essential."

While it was in railroading that the expressive term "featherbedding" was invented, the railway unions have no monopoly on make-work policies. Some of the most flagrant examples today are found in the building trades where resistance to the use of power-driven tools, and reductions in working hours and the daily working stint, are a principal factor in the high cost of housing and home repairs.

The effort always is to make more jobs or to create artificial scarcities for a particular class of labor and thus to enforce higher wage demands. What is too commonly overlooked is that practitioners of these policies always stand the risk of pricing themselves out of the market and coming out in the end with fewer jobs and less work. When the working man does the best job he can with the best tools his employer can provide, he is not only entitled to a higher wage but, by cooperating to lower costs, he helps to bring the products of his industry within range of the buying power of more people. At the same time he makes his fullest contribution to the national product and the national welfare.

Printed in U.S.A.